



# NEWS

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**FOR RELEASE:**  
**May 19, 2003**  
**FHFB 03-16**

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## **ANSWERS ARE THERE TO QUESTIONS ABOUT REGISTRATION BY FEDERAL HOME LOAN BANKS**

*A version of this op-ed column by Chairman John T. Korsmo appeared in the May 19th, 2003, National Mortgage News. The following is the complete text.*

By John T. Korsmo

Ask investors about the value of improving disclosures after a crisis destroys market confidence.

You're right. Not worth much.

Yet some argue that bringing Federal Home Loan Banks' periodic financial and governance reports into compliance with minimum standards for public securities issuers should wait. They contend that investors have not pressed the Banks to register under the 1934 Securities Exchange Act, and so ask, "Why should the Banks volunteer to disclose more?"

This question seems shortsighted to me, and to others who believe in enhancing confidence in the agency debt offered to the investing public. The U.S. Treasury, the Securities and Exchange Commission, and Federal Reserve Board Chairman Alan Greenspan have all advocated more transparency for those government sponsored enterprises that underpin the mortgage-finance and housing sectors of our economy: Fannie Mae, Freddie Mac, and the Federal Home Loan Banks.

To be sure, no one anticipates a crisis. On the contrary. The Federal Home Loan Banks are well capitalized, well collateralized, and are now overseen by a strengthened regulator, the Federal Housing Finance Board.

As Chairman of that regulator, I believe that long-term access to capital markets for FHLBanks demands the Banks follow the same rules accepted by others.

Building a successful real estate title business taught me that our remarkably innovative and liquid residential lending system is built on nationwide acceptance of standard, reliable disclosure about the property's security and a borrower's ability to pay. The underlying principle also allows capital markets to function smoothly.

The world's capital markets fund the housing GSEs. The Federal Home Loan Banks, Fannie Mae, and Freddie Mac leverage their monopoly charters and other privileges granted by Congress to borrow

money in capital markets to provide liquidity to mortgage lenders. The total volume of public debt issued by the FHLBanks alone was just shy of \$10 trillion over the two-year period ending December 31, 2002.

If GSE access to capital markets is interrupted for whatever reason, the consequences might be serious for the Banks and real estate, home building, mortgage lending, and other financial services. Preventing such an event, no matter how unlikely, motivated President Bush's Administration to call on all GSEs to bring disclosures in line with market practices, that is, to give the capital markets more information.

Fannie Mae and Freddie Mac recognized the risk and acted to enhance market confidence by submitting to SEC rules and enforcement.

So, 10 months later, why are some FHLBanks still resisting voluntary '34 Act registration?

In an oddly Washington way, the debate is dominated by those who circulate and re-circulate questions, without bothering to find answers. The board of directors of the FHLBank of Cincinnati attempted to lead their colleagues past this self-fulfilling fear of change by beginning discussions with SEC staff. The FHLBank of Chicago followed suit.

In the meantime, National Mortgage News readers should know that there are answers to these questions.

- Will FHLBank public debt offerings or member stock transactions have to be registered?

No. Those offerings are exempt from the Securities Act of 1933, and no federal agency is proposing repeal.

- Will the FHLBanks have to fold into a holding company or create a "13th entity" for the purpose of registration?

No. The senior SEC official responsible for voluntary registration of GSEs has assured a committee of FHLBank presidents that there is no intention to force such a change.

- Fannie Mae and Freddie Mac stock is traded on the New York Stock Exchange, so why register FHLBank stock, which is not traded publicly?

This is a distinction without a difference, at least in the context of voluntary registration under the '34 Act. Registration of Fannie Mae and Freddie Mac common stock under the '34 Act simply brings their periodic reports under SEC jurisdiction. Registration of FHLBank stock will bring their periodic reports under SEC jurisdiction. It is a mechanism. No more, no less.

In addition, one must remember that, as of March 2003, public investors holding debt securities issued by FHLBanks had \$688 billion invested, while stockholding members of FHLBanks had \$40 billion invested in stock and retained earnings. In this very real sense, all three housing GSEs have "public investors."

- Finally: Might SEC jurisdiction over FHLBank periodic disclosures disrupt their offerings of debt to fund member advance needs?

A few FHLBanks – relying on hired experts, but without testing their assumptions by meeting

with the SEC – argue that the Finance Board can better administer '34 Act standards. They contend that SEC interpretations of its own rules have “unintended consequences,” while Finance Board interpretations of the same standards would not.

If this FHFB-based alternative were meant to be the equivalent of SEC registration, the FHFB would begin with current SEC interpretations and, thereafter, keep pace with changes.

So if these “unintended consequences” appear, they lie not with the choice of agency receiving the periodic filings, but rather in SEC standards evolving to meet market needs.

If the proposers instead intend that the Finance Board “bend” SEC standards, I expect public investors, the SEC, the Fed, and the Administration will see the alternative as hollow.

Taxpayers who chartered FHLBanks, the public investors who fund them, the members who capitalize them and depend on them for liquidity, and financial markets regulators all expect FHLBanks to enhance stability and resiliency in agency debt markets. The Federal Home Loan Banks are thus obliged to perform due diligence before rejecting or agreeing to voluntary SEC registration.

That means each FHLBank should sit down face-to-face with SEC staff to explain the business of its Bank and interests of its members, determine how the SEC will treat key accounting issues, and work to resolve problems.

The FHLBanks of Cincinnati and Chicago have begun this process. Each of the remaining 10 Banks should join them in bringing this debate to an informed conclusion that will serve the broad interests of members, markets, and taxpayers alike.

Not when a crisis of market confidence threatens, but now.

*(John T. Korsmo is Chairman of the Federal Housing Finance Board.)*

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